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RUEHGV/USMISSION GENEVA 2961
RHMFISS/COMUSJAPAN YOKOTA AB JA
RUEHIN/AIT TAIPEI 6243
RUYNAAAC/COMNAVFORJAPAN YOKOSUKA JA
RUCPDO/DEPT OF COMMERCE WASHINGTON DC
RUEHC/DEPT OF LABOR WASHINGTON DC
RULSDMK/DEPT OF TRANSPORTATION WASHINGTON DC
RHMCSUU/DEPT OF ENERGY WASHINGTON DC
RHEFHLC/HOMELAND SECURITY CENTER WASHINGTON DC
RUEKJCS/JOINT STAFF WASHINGTON DC
RHEHAAA/NSC WASHDC
RUEKJCS/SECDEF WASHDC
RUEATRS/TREASURY DEPT WASHDC
RHEHAAA/WHITE HOUSE WASHDC

C O N F I D E N T I A L SECTION 01 OF 04 TOKYO 006764

SIPDIS

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NSC FOR DNSA MCCORMICK AND KTONG
STATE PASS USTR FOR DUSTR BHATIA AND DAUSTR BEEMAN
STATE PASS TO DEPT OF AGRICULTURE
TREASURY FOR U/S ADAMS AND FOR IA/DOHNER, HAARSAGER, AND
POGGI
USDOC FOR U/S LAVIN AND 4410/ITA/MAC/OJ/NMELCHER
STATE FOR E AND EB A/S SULLIVAN
AGRICULTURE FOR USDA/OSEC, FAS/ITP, FAS/FAA/IO/NA
SEOUL PLEASE PASS TO VISITING USDA DEPUTY U/S TERPSTRA
PARIS FOR USOECD
GENEVA ALSO FOR USTR

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TAGS: [ECON](#) [ETRD](#) [PREL](#) [EAGR](#) [ENRG](#) [ECIN](#) [APECO](#) [JA](#)
SUBJECT: SCENESETTER FOR ECONOMIC SUBCABINET MEETINGS, DEC.
6-7

REF: A. TOKYO 5288

- [1](#)B. TOKYO 5600
- [1](#)C. TOKYO 5903
- [1](#)D. TOKYO 6250
- [1](#)E. TOKYO 6501

Classified By: Ambassador J. Thomas Schieffer for reasons 1.4 b/d.

Summary

[1](#)1. (C) Prime Minister Abe has gotten off to a fast start in the beginning of his administration with a strong political and foreign policy agenda. However, he has yet to demonstrate the same leadership on domestic economic policy, regulatory reform, and international economic policy. In preparations for December 6-7 Subcabinet Meetings, we have sensed backsliding in the willingness of our working-level interlocutors to engage in discussion of sensitive topics and opposition to raising the profile of the meetings through press coverage. In this environment, we believe it is important to establish a common medium-term goal of completing a study leading towards a U.S.-Japan Free Trade Agreement (FTA) that will be comprehensive and fully include agriculture. We see exploring an FTA as a way to gauge the level of ambition about economic initiatives and as a means

to prevent drift in the bilateral economic relationship. The subcommittee meetings also provide an opportunity to encourage Japanese domestic economic policy reform, including the continuance and strengthening of the Council for Promotion of Regulatory Reform (CPRR), and to take steps to promote FDI in Japan through stock swaps, which is increasingly under attack. End summary.

Abe Off to a Strong Start Politically...

12. (SBU) Prime Minister Shinzo Abe has demonstrated strong leadership since assuming office on September 26. Moving quickly to defuse tensions with Japan's closest neighbors, Abe pulled off surprise summit meetings in Beijing and Seoul within days of becoming Prime Minister. He showed decisive leadership in response to North Korea's October 9 nuclear test. Abe's emphasis on close ties with the United States and the critical importance of the U.S.-Japan security relationship was highlighted in his meeting with President Bush at APEC and during the October visit of Secretary of State Condoleezza Rice to Tokyo following North Korea's nuclear test. These foreign policy successes have bolstered his public support.

13. (C) Abe came into office with strong conservative credentials and a reputation as a "hard-liner," but has since shown himself to be a flexible, pragmatic, political realist. Reassuring the LDP's pacifist-leaning coalition partner, Komeito, that the LDP will not reconsider Japan's non-nuclear status or push hard in the near term to revise long-standing defense policies, he led his ruling Liberal Democratic Party (LDP) to electoral victories in two Lower House by-elections in October and the Okinawa gubernatorial campaign in

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November. Abe is focused on the elections for the Upper House in the summer of 2007, which could end his tenure if the LDP goes down to defeat. Adopting what some in the media have dubbed a "safe driver" approach, Abe has avoided pushing aggressively on controversial issues in the conservative agenda that might alienate Komeito, spook Japanese voters, or hand the opposition issues to exploit in the summer campaign.

14. (SBU) Abe is now using the momentum from the recent election wins and his high popularity ratings to get his legislative program through the Diet before it recesses on December 15. A new Education Law and a bill elevating the Japan Defense Agency to a Ministry are the two top "to-do" items on Abe's agenda. At the same time, Abe is navigating Diet debates on constitutional revision and a law allowing Japanese Self-Defense Force deployments overseas. Abe's ambitious initiatives to establish new bureaucratic structures and further centralize decision-making within the Prime Minister's Office also remain works in progress.

...But Questions Remain About His Economic Agenda

15. (C) Abe's economic record after two months in office, however, is less clear. As he became prime minister, we identified the new government's commitment to growth and reform, the orientation of its fiscal policy, and its ability to bring strategic coherence to its trade and regional economic relations as key to evaluating the direction and efficacy of his economic leadership (ref A). A review of these areas shows continued commitment on Abe's part, but it also reveals the potential for drift in the bilateral economic relationship.

16. (C) In economic circles, Abe has been generally commended for his personnel choices, particularly at the second-tier level of appointments. Some question whether Minister Koji Omi will be effective at Finance, but the Minister for Economic and Fiscal Policy Hiroko Ota is a protege of former PM Koizumi's reform architect Heizo Takenaka, and his four private-sector selections for the Council on Economic and Fiscal Policy (CEFP) have strong reform credentials (ref B).

Similarly, Abe's new chairman of the Council for Promotion of Regulatory Reform (CPRR), Takao Kusakari, used his first press conference to stress his intention to maintain the pace of regulatory reform.

¶7. (C) Abe has also said the right things publicly about reform and growth. Neatly side-stepping the framing of Japan's public debt burden (over 175% of GDP, the highest in the OECD) as a tax-or-fiscal-restraint issue, Abe has emphasized the need for growth in the Japanese economy. He has even adopted the slogan "Without growth, there can be no fiscal restructuring," a play on PM Koizumi's central challenge that "Without reform, there can be no growth" and a signal of the issue's importance. With that said, some worry that, besides a proliferation of new committees and reform pronouncements, PM Abe has not shown that he is ready or eager to make hard decisions to implement needed reform.

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Even on signature issues like his promises of a "second chance" for those who feel left behind by economic trends, we have not seen the decisions that will guide program-level responses and priorities (ref C and D).

¶8. (C) Furthermore, Abe has not laid down a clear policy line with ministries on international issues that affect the bilateral economic relationship. On the Doha Round, Japan's stance remains a passive one of "wait and see," and his agriculture minister has a reputation as an old-school protectionist (ref E). On regional economic architecture, a tension remains between a more Asia-centric economic policy and recently improved Japanese rhetoric on APEC. On regulatory reform, when we met with CPRR's Chairman Kusakari recently, he expressed great frustration from battling opponents of reform although he had been in office less than a month. There have also recently been worrying signs of backsliding on the liberalization of merger and acquisition rules, particularly for triangular mergers through stock swaps, a key tool for greater foreign direct investment.

¶9. (C) The uncertainty over the economic agenda with the United States is clearly visible when discussion turns to a Free Trade Agreement. In the past month, the Japanese Business Federation (Keidanren), the American Chamber of Commerce in Japan (ACCJ), and the U.S.-Japan Business Council (USJBC) have all endorsed exploring greater integration of the American and Japanese economies, either through an FTA or a so-called "Economic Partnership Agreement" (EPA). From our government contacts, in contrast, we have heard everything from senior Ministry of Foreign Affairs (MOFA) and METI officials supporting the concept, to others in MOFA cautioning that an announcement now of moves toward an FTA might kill any hope of reviving the Doha Round, to strident opposition from the Ministry of Agriculture (MAFF), to uninterested shrugs from the Ministry of Finance (MOF). Or, as a contact in the Prime Minister's Office told us, in the field of economic policy, an FTA with the United States is so far off on the horizon that it just is not getting significant attention.

¶10. (C) In summary, Abe's clear political agenda and leadership have not been matched -- so far -- in international economic policy, making concrete progress difficult in the bilateral economic relationship. The signs of this are evident even in preparation for the December 6-7 Subcabinet Meetings, as we have sensed backsliding in the willingness of our interlocutors to engage in even a pro forma exchange of opinions about an FTA or discussion of food safety issues (reportedly due to MAFF and Ministry of Health, Labor, and Welfare objections). Moreover, working-level contacts seek to keep press coverage of the event to a bare minimum, and we have heard that preparations on the Japanese side have been unusually intense and acrimonious. Perhaps if the Abe administration is in "safe driver" mode, no one wants to be the one caught speeding.

¶11. (C) Because the atmospherics signal the potential for drift in the bilateral economic relationship, we believe it is important to set concluding an FTA study as a medium-term goal, with the understanding that any agreement must include the agricultural sector. Our objective must be to have a pair of economies where it is as easy for an American business to operate in Japan as it is for a Japanese one to operate in the States. We believe that concrete short-term steps are necessary to focus attention on the benefits of the relationship, as well as the link between international agreements and Abe's domestic reform agenda. For example, your visit presents an excellent opportunity to show support for the robust continuance and strengthening of the CPRR and for the legal and tax changes necessary to enable increasing FDI through stock swaps and triangular mergers. Now is a particularly important time on this last issue as the government and LDP are under intense pressure from Keidanren to adopt rules on tax deferral and eligible stocks that will totally gut the possibility of mergers through stock swaps. By insisting on liberalization on these and other immediate issues of concern, we can measure the level of Japan's ambition in moving our economic relationship forward.
SCHIEFFER